In the Supreme Court of the United States

OCTOBER TERM, 1967

No. ——

UNITED STATES OF AMERICA, PETITIONER

v.

TRINITY UNIVERSAL INSURANCE COMPANY AND FIRST NATIONAL BANK IN DALLAS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in the above case.

OPINIONS BELOW

Neither the findings of fact and conclusions of law of the district court (R. 75–83),[1] nor the opinion of the court of appeals (App. 9–15), are yet officially reported.

JURISDICTION

The judgment of the court of appeals was entered on September 12, 1967 (App. 15–16). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] "R." references are to the printed record in the court of appeals. "App." refers to the Appendix to this petition.

284-336—67——1

QUESTION PRESENTED

Whether the United States' right to set off a contractor's unpaid tax debts against a fund it had retained from payments due the contractor before his default on a government construction contract is superior to the claims against the fund of the surety on the contractor's performance bond, the surety having elected to complete the contract in lieu of paying damages to the United States.

STATEMENT

Dallas Building, Inc., was awarded a contract for the construction of a nuclear warfare laboratory at Kirtland Air Force Base, Albuquerque, New Mexico, on March 30, 1961, for the total sum of $1,008,889.36 (R. 75–76; App. 9). Respondent Trinity Universal Insurance Company executed as surety the two bonds required by Section 1 of the Miller Act (Act of August 24, 1935, c. 642, 49 Stat. 793, 40 U.S.C. 270a), one to guarantee the contractor's performance and the other to guarantee payment of laborers and materialmen.

When 90 percent of the contract had been completed the contractor defaulted. The United States terminated its right to proceed further. Under the contract the United States had retained, from progress payments due to the contractor, $39,906.96. There was work remaining to be done having a contract price of $67,276.16. As of that date, federal unemployment,

withholding, and F.I.C.A. tax liabilities of the contractor of $6,495.07 were unpaid. (R. 76; App. 10.)

The surety, in discharge of its obligations, agreed to take over and complete the contract. It paid $116,623.37 to have the work done. The United States paid the surety the contract price of $67,276.16 for that work. In addition, the government paid the surety $33,411.89, this being the difference between the $39,906.96 retainage for work done by the contractor before default and the $6,495.07 owed by the contractor for taxes. (App. 10.)

The surety then brought suit under 28 U.S.C. 1346 (a)(2) to recover the $6,495.07 setoff.[2] The district court rejected the claim upon the authority of *United States* v. *Munsey Trust Co.*, 332 U.S. 234. (App. 11). The surety appealed, and the Court of Appeals for the Fifth Circuit reversed, holding that the United States' right of setoff was inferior to the surety's claim to the retained fund (App. 15, 16).

REASONS FOR GRANTING THE WRIT

1. The Court of Claims in *Standard Accident Ins. Co.* v. *United States*, 97 F. Supp. 829, in circumstances identical to those of this case, held that the

[2] The First National Bank in Dallas, to which the contractor had also assigned its contract rights against the government, joined in the suit. The district court held that the sole purpose of the assignment of contract rights to the bank was to deprive the government of its right to setoff for its taxes. (R. 81.) On appeal the bank dropped its action based on the assignment, and only the rights of the surety are in issue.

government's right to a setoff is superior to the claims of a surety. As the Fifth Circuit acknowledged (App. 14), there is a direct conflict between it and the Court of Claims.

2. The question presented is of substantial importance, and it is therefore appropriate for this Court to resolve the conflict.[3] *United States* v. *Munsey Trust Co.*, 332 U.S. 234, held that the United States has a right of setoff against a retained fund that is superior to the rights of a surety on a Miller Act payment bond. This Court did not have before it, and did not decide, the question whether the same result would follow in the case of a performance bond. Although parts of this Court's opinion in *Munsey Trust* may be read as suggesting that the rule might be different

[3] The Federal Tax Lien Act of 1966, P.L. 89-719, 80 Stat. 1125, Sec. 105(b), added the following subsection to Section 1 of the Miller Act:

> (d) Every performance bond required under this section shall specifically provide coverage for taxes imposed by the United States which are collected, deducted, or withheld from wages paid by the contractor in carrying out the contract with respect to which such bond is furnished. * * *

The amendment became effective November 3, 1966, subsequent to the time when this controversy arose. The purpose of this amendment was to make sureties absolutely liable for tax liabilities of the contractor arising from the contract subject to the bond, whether or not there were retainages against which a setoff could be asserted (S. Rep. No. 1708, 89th Cong., 2d Sess., p. 23). The record before the district court showed (R. 3, Ex. 1) that at least some of the taxes at issue in this case related to 1959, before Dallas Building, Inc. began work on the job whose performance Trinity Universal guaranteed, and this case therefore poses an issue not resolved by the new Act. (Exhibit 1 is not in the printed court of appeals record. A copy is being filed with the clerk.)

in the latter circumstance, see 332 U.S. at 242–243, the United States has routinely exercised the right of setoff against a surety on a performance bond who elects to complete the contract, and thus becomes entitled to the retained fund. The paucity of litigated cases[4] suggests that sureties, just as routinely, have acquiesced in such setoff. The decision below, in holding that the setoff is improper, is likely to increase litigation of this issue, unless the resulting uncertainty is put to rest by this Court.

3. We submit that the decision of the court of appeals is erroneous and that the conflicting decision of the Court of Claims in *Standard Accident Ins. Co.* v. *United States, supra,* is correct. The Fifth Circuit's analysis turns on its conclusions that "the surety is * * * a subrogee of the government and entitled to any rights the government has to the retained funds" (App. 13). In support, it cited cases such as *Prairie State Bank* v. *United States,* 164 U.S. 227, *Henningsen* v. *U.S. Fidelity & Guaranty Co.,* 208 U.S. 404, and *Pearlman* v. *Reliance Ins. Co.,* 371 U.S. 132. But in those cases the United States either was not a party or was in effect a nominal party, or stakeholder. *Munsey Trust* expressly noted (332 U.S. at 240) that the ambit of those cases does not include circumstances such as the present case, where the United States is a party with a direct financial interest in the dispute.

There is nothing in the language in the *Munsey* case which affects this position. The court there

[4] We are aware of no such reported cases other than this one and *Standard Accident Ins. Co.* v. *United States, supra.*

said that the surety on a payment bond has gained nothing by claiming the rights of the laborers and materialmen whom it had paid, since retainages are intended to insure performance rather than payment. But retained progress payments due the contractor, based on work performed prior to default, are retained solely for the benefit of the United States, and in amounts and for a period controlled largely by its own discretion. Where the United States is both a debtor and a creditor, retainages should be no more available to the surety than amounts previously paid to the contractor and no longer available. To give the surety priority to such amounts constitutes a windfall clearly not contemplated by the surety at the time of its initial undertaking, as provided for in the contracts.

That the surety claims through a performance rather than a payment bond presents no difference of substance that warrants enhancing his rights against the retained fund. Those rights should be limited here, as they were in *Munsey Trust*, to the claims of a subrogee of the contractor. Since the United States would have had an unquestioned right to exercise its right of setoff before paying the fund to the contractor, it should have no lesser right as against the contractor's surety.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted.

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